

Internal Revenue Service

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LEGEND

X =

A =

Trust 1 =

Trust 2 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

State =

Dear :

This responds to a letter dated July 6, 2010, submitted on behalf of X by X's authorized representative, requesting relief under section 1362(f) of the Internal Revenue Code (the Code).

FACTS

According to the information submitted, X was incorporated on Date 1 under the laws of State. Effective Date 2, X elected to be taxed as an S corporation. On Date 3, A, a shareholder of X, died. Following A's death, A's estate, pursuant to the terms of A's will, transferred shares of X to Trust 1.

On Date 4, Trust 1 distributed the X stock to Trust 2. The trustees of Trust 2, did not make a timely election to treat Trust 2 as an ESBT causing a termination of X's S corporation status.

X represents that Trust 2 has at all times met the requirements of an ESBT within the meaning of § 1361(d)(3).

X further represents that its S corporation election termination was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments the Commissioner may require, consistent with the treatment of X as an S corporation.

LAW AND ANALYSIS

Section 1361(a)(1) of the Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(iii) provides that, for purposes of § 1361(b)(1)(B), a trust, with respect to stock transferred to it pursuant to the terms of a will, may be a shareholder, but only for the 2-year period beginning on the day on which such stock is transferred to it.

Section 1361(c)(2)(A)(v) provides that, for purposes of § 1362(b)(1)(B), an electing small business trust (ESBT) may be an S corporation shareholder.

Section 1361(e) provides that an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust.

Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b); (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of such corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's election to be an S corporation terminated on Date 4 and that the termination of X's S election was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation effective Date 4 and thereafter, provided X's S corporation election is not otherwise terminated under § 1362(d). Moreover, Trust 2 will be treated as an ESBT from Date 4.

This ruling is contingent upon the filing of an election to treat Trust 2 as an ESBT effective Date 4 within 120 days of the date of this letter with the appropriate service center. A copy of this letter should be attached to the ESBT election.

The shareholders of X must include in their income their pro rata share of separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. Further, to the extent necessary, Trust 2 must file amended returns to treat itself as an ESBT within the earlier of the expiration of the statute of limitations for the respective period or 120 days of the date of this letter.

Except as specifically ruled upon above, we express or imply no opinion concerning the federal tax consequences of the facts of this case under any other provision of the Code. Specifically, we express or imply no opinion regarding X's eligibility to be an S corporation.

This ruling is directed only to the taxpayer who requested it. According to § 6110(k)(3), this ruling may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Faith Colson

Faith Colson
Senior Counsel, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for section 6110 purposes